Clarity and transparency matters

PIAC's submission on National Electricity Amendment (DWGM-AMDQ Allocation) Rule 2015

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1. The Public Interest Advocacy Centre

The Public Interest Advocacy Centre (PIAC) is an independent, non-profit law and policy organisation that works for a fair, just and democratic society, empowering citizens, consumers and communities by taking strategic action on public interest issues.

PIAC identifies public interest issues and, where possible and appropriate, works co-operatively with other organisations to advocate for individuals and groups affected. PIAC seeks to:

- expose and redress unjust or unsafe practices, deficient laws or policies;
- promote accountable, transparent and responsive government;
- encourage, influence and inform public debate on issues affecting legal and democratic rights;
- promote the development of law that reflects the public interest;
- develop and assist community organisations with a public interest focus to pursue the interests of the communities they represent;
- develop models to respond to unmet legal need; and
- maintain an effective and sustainable organisation.

Established in July 1982 as an initiative of the (then) Law Foundation of New South Wales, with support from the NSW Legal Aid Commission, PIAC was the first, and remains the only broadly based public interest legal centre in Australia. Financial support for PIAC comes primarily from the NSW Public Purpose Fund and the Commonwealth and State Community Legal Services Program. PIAC also receives funding from NSW Trade and Investment for its work on energy and water, and from Allens for its Indigenous Justice Program. PIAC also generates income from project and case grants, seminars, consultancy fees, donations and recovery of costs in legal actions.

1.1 Energy + Water Consumer's Advocacy Program

This Program was established at PIAC as the Utilities Consumer's Advocacy Program in 1998 with NSW Government funding. The aim of the program is to develop policy and advocate in the interests of low-income and other residential consumers in the NSW energy and water markets. PIAC receives policy input to the program from a community-based reference group whose members include:

- Council of Social Service of NSW (NCOSS);
- Combined Pensioners and Superannuants Association of NSW;
- Tenants Union of NSW;
- Ethnic Communities Council of NSW;
- Physical Disability Council of NSW;
- St Vincent de Paul Society of NSW; and
- The Salvation Army Eastern Australia Conference.

2. Introduction

PIAC welcomes the opportunity to comment on the Australian Energy Market Commission's (AEMC) *Draft Rule Determination: National Gas Amendment (DWGM-AMDQ Allocation) Rule 2015* (preferable draft rule).[1] This proposed rule change was initiated by the Australian Energy Market Operator (AEMO) to amend and clarify the framework for allocating market benefit instruments (authorised Maximum Daily Quantity (MDQ) and Authorised Maximum Daily Quantity credit certificates AMDQcc).

New MDQ and AMDQcc instruments are created when the Victorian declared transmission system (DTS) is either expanded or extended to create additional capacity in the system. AEMO has identified that the current arrangements are insufficient and create confusion amongst market participants. This contributes to existing issues in the market, which make it difficult for new entrants to enter the market, create uncertain reference pricing and fail to create adequate financial incentives to expand the system.[2]

The Victorian declared wholesale gas market (DWGM) operates as a market carriage pipeline system. This means that capacity is allocated through a pool and participants do not have firm (guaranteed) capacity allocation rights. When there are capacity restrictions, such as during winter when there is higher demand for space, capacity is determined using market instruments that offer limited physical benefits along with market benefits.[3] There are two types of market instruments; the first type is the authorised MDQ instrument that is applied only to the historic Longford to Melbourne pipeline and is held indefinitely. This instrument can be transferred to another party and transferred back when no longer needed. The second type is the AMDQ credit certificate, which is created when the pipeline owner, APA Group (APA), who contracts the market operation to AEMO, agrees to extend or expand the Victorian DTS. This instrument is usually held for a set period of time and can be transferred to another party but it cannot be extended beyond the original period.[4]

Both types of market instruments provide some physical benefits, including protection against curtailment and priority injection into the system ahead of others who do not hold either an MDQ or an AMDQ. The market rights include priority in scheduled injections when there are equal bids on injections into the system, and reduced uplift payments. Uplift payments occur when there is congestion in the system or demand differs from the predicted or planned capacity.[5]

In addition to paying for access arrangements, participants are required to pay a reference tariff or a negotiated tariff for transportation services to APA. The Australian Energy Regulator (AER) sets the tariff every five years through an access arrangement. The reference tariff is bundled with the AMDQcc price and pre-paid by the contract holder. Through this mechanism there is the potential for APA to over-recover costs and this AMDQcc rule change makes suggestions about how to manage this.[6]

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1 AEMC, *Draft Rule Determination. National Gas Amendment (DWGM-AMDQ Allocation) Rule, 2015.*
2 Ibid iii.
3 Ibid 1.
4 Ibid 2-3.
5 Ibid 2.
6 Ibid 8.

The current rule makes recommendations about which body should manage the allocation of the market instruments, but current practice overlooks these. The requirement stipulates that if 100% of the cost of the expansion of the pipeline is included in the APA's regulated capital base then an AMDQcc is created and the allocation is undertaken by the AEMO. If the expansion is only partially or not at all included in the APA's regulated capital base then either an MDQ or an AMDQcc is created for the proportion that is included in the capital base, which is managed by AEMO, and an MDQ or an AMDQcc is created for the proportion not included in the capital base which is managed by APA. However, current practice sees only an AMDQcc being created, which APA manages regardless of the proportion of the expansion that is included in the regulated capital base.[7] The proposed rule change seeks to clarify these arrangements and seeks to remove APA's ability to over-recover costs.

3. Preferred rule

The AEMO, as the rule proponent, proposed a rule change to address the issues identified above. The AEMC, after consultation with stakeholders on the proposed rule, has developed a preferable draft rule that it suggests will better address the issues. Given the nature of the changes and feedback, the AEMC has split the rule into the non-controversial and controversial aspects of the rule change. This submission will address both aspects of the preferable draft rule change.

3.1 Non-controversial aspect of rule

The non-controversial proposed changes are:

- Clarify which market instrument is created upon the expansion of the system
  - MDQ would only relate to the historic capacity on the Longford to Melbourne pipeline
  - AMDQcc would apply when expansions create new capacity and therefore new market instruments
- AEMO would be required to use proceeds from the allocation of market instruments to offset the operating costs of the Victorian DWGM
- AEMO would provide 20 business days notice prior to opening the allocation for either MDQ or AMDQcc[8]

PIAC supports these steps to improve clarity about the allocation of market instruments and the use of the proceeds to lower the operation costs of the market, on the basis that they will have positive flow-on effects for consumers.

Recommendation 1

PIAC recommends that the above changes be made the current rule to improve the allocation of market instruments.

7 Ibid 6-7.
8 Ibid 14.

3.2 Controversial aspect of rule change

The following components of the rule change are more controversial amongst the stakeholders who responded to the discussion paper in October 2015. These proposed changes address the issue of which body should be responsible for allocating the market instruments:

- AEMO would be responsible for the allocation of all MDQ
- AEMO would be responsible for the allocation of AMDQcc where the costs of the expansion are included in APA's opening capital base or approved capital expenditure for an access arrangement period
- APA would be responsible for the allocation where the costs of expansion are not included in APA's approved capital base or expenditure.[9]

The original rule change proposed that APA allocate all new market instruments, regardless of whether an asset is included in the regulated capital base.[10] The preferable rule maintains that the body responsible will differ based on based on whether or not the asset is included in the capital base. The rationale for this is to prevent APA from over-recovering costs through this mechanism.

PIAC supports the proposal to reduce the potential for over-recovery in the system. However, PIAC is of the view that it would be more efficient if the AEMO was responsible for the allocation of all market instruments regardless of the status of the asset's inclusion in the APA's regulated capital base or expenditure. AEMO is the system operator and leases infrastructure from APA; therefore it is PIAC's view that it would be more transparent if the system operator had sole responsibility for the allocation of these market instruments. APA would nevertheless be able to recover the costs of its investment via tariff services and from its contract with the AEMO. This change would also provide additional revenue for AEMO to use for its operations. It would also reduce any confusion about switching responsibility when assets are included or removed from the regulated capital base in subsequent access arrangements. Overall, these measures would streamline and improve transparency in the system and provide clarity in roles and responsibilities and in turn in protections for consumers.

Recommendation 2

PIAC recommends that the AEMO should be the responsible party for the allocation of all market instruments (MDQ or AMDQcc) regardless of how much of APA's new asset is included in the regulated asset or capital base.

3.2.1 Unbundling AMDQcc from the reference tariff

At the moment, the payment for market benefits and pre-payment of the reference tariff are bundled together. APA uses this as a mechanism to hedge against demand forecast risk. This has been flagged as an issue of concern, given that the participant pre-pays for transportation for a given volume of gas whether or not they end up shipping that amount. If the market instrument is transferred to a third party, they are also then required to pay the transportation tariff and the existing holder is not refunded their pre-paid tariff. APA refunds the double payments back to all system participants via a reduced annual tariff adjustment. However, this does not fully

[9] Ibid 15.
[10] Ibid 21.

compensate the parties who have paid additional payments. Additionally, parties who did not end up paying more are also given a reduction even though they do not require one.[11] This process is not transparent and the move to unbundle these payments is a positive step towards ensuring that customers are not paying more than they should for distribution and transportation services. The AEMC has indicated that there are other methods that could be used by APA to reduce demand risks. At the moment the unbundling of the two payments is referenced in the AEMC's assessment of the rule change, but is not specifically included in the preferable rule change. PIAC recommends that the preferable rule change include a clear provision to unbundle the reference tariff for transportation services and the market instrument.

Recommendation 3

PIAC recommends that that the preferable rule change clarify provisions to unbundle the tariff and market instrument payments.

4. Future of the DWGM

If this rule change proceeds, transitional arrangements will have to be implemented. The timing of changes will need to be in line with APA's next access arrangement period, which is 2018-2022. Depending on the outcomes of the east coast gas market and Victorian declared wholesale gas market reviews, and the implementation of any changes resulting from these reviews; this rule change may only be a temporary measure. This is particularly the case if the AEMC's recommendation to make the Victorian DWGM a virtual market with an entry/exit system that would become the southern hub for the larger system is taken up. If the Victorian DWGM becomes an entry/exit system, participants will not be required to purchase market instruments such as the AMDQcc to manage capacity. This is because participants would book capacity at each entry/exit point, which would create different risk outcomes and create new signals for investment in the system.[12]

PIAC supports the rule change and the reasons behind the change. However, PIAC is aware that there may be a need to find an alternative process given the potentially short-term nature of the change. PIAC also notes that under the present rules there is an established process similar to aspects of the proposed rule change but the issue is that this process is not currently being followed. If the AEMC determines that the costs of the rule change outweigh the benefits, PIAC recommends that the current rules are more strongly enforced and participants use the process set out in the current rules rather than the informally adopted process that leaves the allocation of AMDQcc with APA. This would not be a perfect approach, but if the market design undergoes a significant overhaul there will be an opportunity to address some of the other issues during that process, such as the unbundling of the reference tariff and market instrument purchase.

Recommendation 4

PIAC recommends that the AEMC adopt all components of the preferable rule including the controversial aspects, to improve clarity in the allocation of AMDQcc.

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[11] Ibid 28.
[12] Ibid 34.

Recommendation 5

PIAC recommends that if the AEMC decides not to proceed with the rule change, that the current rules be better enforced to end the more generally adopted process which allows APA to allocate all market instruments regardless of whether the expansion is included in its regulated capital base.

Recommendation 6

PIAC recommends that if the rule change is not adopted, measures be taken to address the issue of double charging via the bundling of the reference tariff and the purchase of the market instruments.

5. Conclusion

The east coast gas market is undergoing a significant transition, hopefully one that will benefit consumers. Ensuring that there is transparent allocation and price for capacity is a critical piece of the broader reform. Transparent pricing in the market will enable consumers and their representatives to monitor the effect of wholesale and market prices on retail prices. Transparent pricing will also enable new entrants to enter the market by reducing the costs of accessing information. Moreover, improved access to transmission pipelines should reduce the costs of transporting gas, which should in turn be passed on to consumers.

PIAC supports the proposed changes in the preferable rule and encourages the AEMC to remove any allocation of AMDQcc role from APA, on the basis that AEMO is the body best placed to allocate this market instrument. PIAC is mindful that these are the early stages of a major reform process and therefore notes that these and other regulatory changes to the market should be introduced alongside regular monitoring and review processes to ensure that the touted benefits occur and are passed on to consumers.